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No. _____

IN THE

Supreme Court of the United States

OCTOBER TERM 1982

ELLIS BANKING CORPORATION,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

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QUESTION PRESENTED

ARE EXPENDITURES MADE BY A BANK HOLDING COMPANY IN THE INVESTIGATION OF THE FINANCIAL CONDITION OF A BANK, PRIOR TO MAKING THE DECISION TO ACQUIRE THE BANK, DEDUCTIBLE AS ORDINARY AND NECESSARY BUSINESS EXPENSES UNDER SECTION 162 OF THE INTERNAL REVENUE CODE?

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	)	
Respondent.	)	
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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

Ellis Banking Corporation respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Eleventh Circuit in *Ellis Banking Corporation v. Commissioner of Internal Revenue*, 688 F.2d 1376, entered October 15, 1982 and issued as mandate on March 4, 1983.

OPINIONS BELOW

The opinion of the United States Tax Court is a memorandum decision, *Ellis Banking Corporation v. Commissioner of Internal Revenue*, 41 T.C.M. 1107, 1981 P-H TC Memo ¶81,123 (1981) and is reprinted in the appendix to this Petition. The opinion of the court of appeals is reported at 688 F.2d 1376 and is also reprinted in the appendix to this Petition.

JURISDICTION

The Court of Appeals issued its decision on October 15, 1982. Petitioner thereupon filed a timely Petition for Rehearing and Suggestion for Rehearing En Banc. On January 31, 1983 the Court of Appeals denied the Petition and Suggestion. This Petition was filed within 90 days of the latter date. This Court has jurisdiction to review the judgment below under 28 U.S.C. §1254(1).

STATUTES INVOLVED

Internal Revenue Code § 162(a):

SEC. 162. TRADE OF BUSINESS EXPENSES.

(a) IN GENERAL. - There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including —

(1) a reasonable allowance for salaries or other compensation for personal services actually rendered;

(2) traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business; and

(3) rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * *

Internal Revenue Code § 263(a):

SEC. 263. CAPITAL EXPENDITURES.

(a) GENERAL RULE. - No deduction shall be allowed for —

(1) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate. This paragraph shall not apply to —

(A) expenditures for the development of mines or deposits deductible under section 616,

(B) research and experimental expenditure deductible under section 174,

(C) soil and water conservation expenditures deductible under section 175,

(D) expenditures by farmers for fertilizer, etc., deductible under section 180, or

(E) expenditures by farmers for clearing land deductible under section 182.

(2) Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made,

(3) Except as provided in subsection (d), any amount paid as tax under section 4911 (relating to imposition of interest equalization tax).

STATEMENT OF THE CASE

A. Procedural Background.

On September 28, 1978, the Commissioner of Internal Revenue ("Commissioner") mailed to Ellis Banking Corporation ("Ellis") a notice of deficiency with respect to Ellis' 1974 tax year. Included in the deficiency was the disallowance of a deduction which represented certain expenses Ellis incurred in investigating the financial condition of Parkway National Bank of Tallahassee ("Parkway") *prior to its decision to acquire Parkway's stock.*

B. Factual Background.

Ellis is a registered bank holding company organized in March 1972 with 15 banks as subsidiary corporations. During the year in issue, branch banking was prohibited by Florida law. However, the bank holding company concept was popular in Florida because it provided the only vehicle for a bank to expand into new geographic markets. By using a bank holding company, a bank's business could be expanded either by acquiring the stock of existing banks or by organizing new banks. Since 1972, and up to the time of the trial of this case in the Tax Court, Ellis organized or acquired control of fourteen banks. Ellis is an aggressive organization that is constantly looking for new markets to enter.

Ellis is in the banking business and it acquires, operates and manages banks as its trade or business. The following procedure is generally followed by Ellis in acquiring an existing bank and was the procedure in this case:

1. Oral discussions take place between officials of Ellis and the target bank.

2. A letter of intent is signed by the parties, stating, in rather general terms, Ellis' intent to acquire the bank upon certain terms and conditions.

3. An agreement of sale and purchase is executed setting forth the terms of the proposed purchase. The agreement will normally contain numerous conditions precedent which must be met before Ellis is obligated to close the transaction.

4. Ellis investigates the target bank to determine whether its financial condition is as represented in the agreement of sale and purchase. This phase normally involves an audit performed by Ellis. A target bank will normally not permit a prospective purchaser to investigate the target's books and records, until an Agreement of Sale and Purchase has been executed.

5. After the investigation is completed, a determination is made as to whether or not the bank to be acquired has satisfied the conditions stated in the agreement and whether or not the proposed transaction should be closed.

6. If Ellis decides to close the purchase, a final determination of purchase price is made reflecting any adjustments called for by the agreement, based primarily on the financial condition of the target bank.

7. An application is made to the Federal Reserve Board for approval of the proposed transaction.

8. If the Federal Reserve Board rules favorably on the proposed transaction and if the other conditions precedent to the sale are met, a closing takes place.

It is Petitioner's position in this case that all expenses incurred in investigatory steps 1, 2, 3 and 4 are ordinary and necessary business expenses and currently deductible; all expenditures incurred in subsequent steps 5, 6, 7 and 8 are capital items.

C. **Bank Acquisition in Issue.**

By letter dated June 11, 1973, Ellis offered, subject to certain terms and conditions, to exchange shares of its common stock for the shares of Parkway. The offer contained in the letter was the result of prior discussions between Ellis and Parkway and reflected a preliminary agreement between them as to the purchase price and its conditions. Parkway's board of directors approved Ellis' offer on June 14, 1973.

On August 21, 1973, Ellis, Parkway and certain of Parkway's shareholders executed an agreement for the acquisition by Ellis of Parkway's common stock. This Agreement contained the following conditions:

1. The holders of at least 90 percent of the outstanding shares of Parkway would tender their shares to Ellis under the terms of the exchange offer.

2. The stock acquisition would qualify as a tax-free reorganization.

3. The Board of Directors of the Federal Reserve System would approve Ellis' application to acquire the Parkway stock and all other required governmental approvals would be obtained.

4. The Securities and Exchange Commission would declare effective the registration of Ellis stock to be exchanged for Parkway stock.

5. For accounting purposes, Ellis would be able to treat the acquisition of Parkway stock as a "pooling of interests."

6. Material adverse changes would not have occurred in Parkway's financial condition as set forth in the financial statement which Parkway supplied to Ellis.

If any of the above conditions had not been met, Ellis could

have withdrawn from the transaction. Alternatively, Ellis could have waived any condition except for certain governmental approvals of the transaction. The agreement also authorized Ellis to examine Parkway's books and records to compile the information needed to be submitted to various government agencies and to insure that the financial information presented by Parkway was accurate, would not affect the exchange ratio of Ellis stock for Parkway stock and to review records required for Ellis' consolidated statements.

Subsequent to the agreement of August 21, 1973, Ellis' employees and its independent certified public accounting firm, conducted an examination of Parkway's books and records. In connection with that examination, Ellis incurred certain investigatory expenses. Ellis deducted these amounts as ordinary and necessary business expenses on its 1974 income tax return. These expenses were incurred after the execution of the Agreement of August 21, 1973. The investigative expenses incurred involved verifying facts and figures presented by Parkway and compiling information for filing with various governmental agencies.

As a result of the investigation by Ellis of Parkway's books and records, Ellis found a material adverse change in Parkway's condition and this necessitated a downward adjustment to the purchase price of the Parkway stock. Had Parkway and its directors not agreed to the downward adjustment, Ellis would have abandoned the acquisition. Ellis has decided in the past, after investigating a proposed acquisition of a bank, not to consummate the transaction. The Federal Reserve Board, on occasion, has disapproved proposed acquisition by Ellis with the result that the transaction was not consummated.

Federal Reserve Board approval of the acquisition was obtained and on July 12, 1975, Ellis acquired all of the stock of Parkway in a non-taxable stock exchange.

The final decision to acquire the stock of Parkway was made after all of the expenses in issue were incurred.

D. **The Court of Appeals Decision.**

At the time this case are argued before the Eleventh Circuit, the court was advised that another case, also involving investigatory expenses, had been reargued *en banc* before the Fourth Circuit. This case is *NCNB Corporation v. United States*, 651 F.2d 942, *vacated pending rehearing en banc;* 684 F.2d 285 (en banc, 1982). On July 13, 1982 the Fourth Circuit issued its *en banc* opinion and on July 26, 1982, petitioner filed a Notice of Supplemental Authority, advising the Eleventh Circuit panel of the Fourth Circuit's opinion.

Despite this prompt notification, the Eleventh Circuit issued its opinion in this case on October 15, 1982 without any reference to the Second *NCNB Corporation* case in the body of its opinion. The opinion did, however, contain an interesting footnote which indicates that the Eleventh Circuit was apparently unaware of the Fourth Circuit's *en banc* turnabout. It reads, in part, as follows:

> * * * If the view of the panel in NCNB does not prevail on rehearing, this latter distinction may present an anomaly: a bank that expands into new markets by branching can deduct investigation costs while a bank that expands into new markets by acquiring the stock of other banks must capitalize those investigation costs. But we think that the anomaly militates in favor of recognizing that investigation by a branching bank of specific potential branch locations creates an asset, the cost of which should be capitalized rather than adopting the fiction that the investigation of a potential subsidiary by a bank holding company is not connected to, the acquisition of shares of stock that are undeniably an asset with an extended useful life.

Footnote 7 at page 1380; page A-8 of Appendix.

What the Eleventh Circuit is saying, in effect, is that if the Fourth Circuit *does* reverse its position in the *NCNB Corporation* case, it will be in conflict with the Eleventh Circuit holding. The Fourth Circuit, *en banc, did* reverse itself and the circuits are squarely in conflict on the issue presented in this case.

This honorable Court should resolve the conflict.

REASONS FOR GRANTING THE WRIT

The court below, on October 15, 1982, affirmed a decision of the United States Tax Court on an issue that was decided contrarily by the Court of Appeals for the Fourth Circuit on July 13, 1982, three months earlier, based on a decision of this honorable Court. In rendering its decision in the instant case the Eleventh Circuit Court of Appeals failed to consider the decision of the Fourth Circuit in *NCNB Corporation v. United States*, 648 F.2d 285 (4th Cir. 1982).

The issue involved is the deductibility of investigatory costs incurred in reviewing a prospective business prior to reaching a final decision to acquire that business. Petitioner believes that the opinion of the court below is in conflict with the Fourth Circuit's well reasoned opinion in the *NCNB Corporation* case. Petitioner suggests that this Court grant certiorari in this case for the following compelling reasons:

1. **The One-Year Test.** The court below, in adopting the "one-year" test for the deduction of current expenditures is clearly out of step with the interpretation of *Commissioner v. Lincoln Savings and Loan Association*, 403 U.S. 345 (1971) by the Fourth Circuit in *NCNB Corporation*. There the Fourth Circuit said:

> "In light of the unmistakable language in *Lincoln Savings & Loan* that 'the presence of an ensuing benefit . . . is not controlling.' we conclude that such parts of *Richmond Television, Darlington-Huntsville,* and *Georator* as may be interpreted as establishing a one-year standard for distinguishing between capital and current costs, are no longer authoritative."

The court below based its opinion in this case upon an erroneous reading of Section 263 of the Internal Revenue Code when it stated (at page 1379; page A-6 of the Appendix):

> ". . . Section 263 denies a deduction for any amounts paid out for assets with lives in excess of one year."

Nowhere does Section 263 make any reference to one year, or any other period of time, as the touchstone for deductibility. This is a rule of thumb promoted by the Internal Revenue Service and adopted by some courts. It has been rejected by the Second Circuit Court in *Briarcliff Candy Corp. v. Commissioner,* 475 F.2d 775 (2nd Cir. 1973) and by the Fourth Circuit in *NCNB Corporation, supra.* Even the Tenth Circuit, one of the first advocates of the "one-year rule" has receded from it. *U.S. v. Wehrli,* 400 F.2d 686, 689 (10th Cir. 1968). The Court of Claims does not consider the "one-year rule" determinative. *Southland Royaly Co. v. U.S.,* 582 F.2d 604 (Ct. Cl. 1978), *cert. denied,* 441 U.S. 905 (1979).

This Court should correct the Eleventh Circuit's misreading of Section 263.

2. **The Intent of Congress.** The Fourth Circuit held, in its reconsideration of *NCNB Corporation, supra,* at page 291, that the enactment of Section 195 by Congress in 1980 to permit the amortization of "startup" expenses in connection with a new business, assumed that investigatory expenses were fully deductible if incurred by an existing business undergoing expansion. This is borne out by the Senate Committee Report which states:

> "In the case of an existing business, eligible start-up expenditures do not include deductible ordinary and necessary business expense paid or incurred in connection with an expansion of the business. *As under present law, these expenses will continue to be currently deductible.*" [Emphasis added.] Sen. Rep. No. 1036, 96th Cong., 2nd Sess. 11. (1980).

As the Fourth Circuit found in *NCNB Corporation*, any other interpretation would render Section 195 meaningless for it would obliterate the reference point in the Statute — "The expansion of an existing trade or business."

3. **Contract Expenses are not Capital Items.** Investigatory costs expended by Appellant were not directly connected with the acquisition of the stock of Parkway. They were directly related to *making the decision* as to whether the Parkway National Bank should be acquired.

The contract between Appellant and Parkway contained six conditions precedent, each of which required satisfaction before the contract was binding on the parties. The expenses of the investigation were so preliminary to the actual acquisition of Parkway as to be only distantly related. They were expenditures with respect to the contract between the parties and pertained only remotely to the acquisition.

The Second Circuit in *Briarcliff Candy Company v. Commissioner*, 475 F.2d 775 (2nd Cir. 1973) held that contracts without an ascertainable and measurable value in money, or in fair market value, were not capital assets and that expenses pertaining to them were currently deductible.

It is clear that the conditioned contract to acquire Parkway had no measurable value and the investigatory expenses connected with it are deductible.

IV.
CONCLUSION

A reasoned application of this Court's determination in *Lincoln Savings and Loan Association*, as interpreted by the Fourth Circuit's *NCNB Corporation* opinion and the other authorities cited, makes it imperative that this Court correct the position taken by the Eleventh Circuit. By embracing the one-year rule as the test for determining the difference between a deductible expense and a capital expenditure, the court below moved away from the prevailing law. As pointed out in *NCNB Corporation*, there is no sound authority for the rule and it is being discarded by the other courts of appeals.

Respectfully submitted,

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PROOF OF SERVICE

I HEREBY CERTIFY that on this 22 day of April, 1983, three copies of the Petition for a Writ of Certiorari in the case of *Ellis Banking Corporation v. Commissioner of Internal Revenue* were mailed, first-class postage prepaid to the Solicitor General, Tax Division, United States Department of Justice, Washington, D.C. 20530, Counsel for Respondent. I further certify that all parties required to be served have been served.

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ELLIS BANKING CORPORATION,
Petitioner-Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

No. 81-5895.

United States Court of Appeals,
Eleventh Circuit.

Oct. 15, 1982.

Rehearing and Rehearing En Banc
Denied Jan. 31, 1983.

Taxpayer appealed from a decision of the Tax Court, which disallowed its deduction for expenditures made in the investigation of the financial condition of the corporation in preparation for a proposed acquisition of its stock. The Court of Appeals, Wisdom, Circuit Judge, held that: (1) expenditures made in investigation of financial condition of a corporation, in preparation for a proposed acquisition of its stock, were required to be capitalized, and (2) if taxpayer could establish that part of the charges of its accountant were attributable to its performance of general auditing duties rather than investigation of financial condition of a corporation in preparation for a proposed acquisition of its stock, Tax Court would be required to estimate the amount allocable to general auditing and permit a deduction in that amount.

Affirmed in part and remanded in part.

1. Internal Revenue 3318

To be deductible as an ordinary and necessary business expense, an expenditure must be paid or incurred during the taxable year, must be made to carry on a trade or business, must be

an expense, must be a necessary expense and it must be an ordinary expense. 26 U.S.C.A. § 162.

2. Internal Revenue 3334

Requirement that costs be capitalized extends beyond price payable to seller to include any costs incurred by buyer in connection with the purchase of a capital asset, such as appraisals of the property or the costs of meeting any conditions of the sale. 26 U.S.C.A. § 263.

3. Internal Revenue 3334

An expenditure that would ordinarily be a deductible expense must nonetheless be capitalized if it is incurred in connection with acquisition of a capital asset. 26 U.S.C.A. § 263.

4. Internal Revenue 3334

Expenditures made in investigation of financial condition of a corporation, in preparation for a proposed acquisition of its stock, were required to be capitalized. 26 U.S.C.A.§ 263.

5. Internal Revenue 3334

Expenditures made with contemplation that they will result in creation of a capital asset cannot be deducted as ordinary and necessary business expenses even though that expectation is subsequently frustrated or defeated; nor can the expenditures be deducted because the expectations might have been but were not frustrated. 26 U.S.C.A. §§ 162, 263.

6. Internal Revenue 3334

If taxpayer could establish that part of the charges of its accountant were attributable to its performance of general auditing duties rather than investigation of financial condition of a corporation in preparation for a proposed acquisition of its stock, tax court would be required to estimate the amount allocable to general auditing and permit a deduction in that amount. 26 U.S.C.A. §§ 162, 263.

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John F. Murray, Act. Asst. Atty. Gen., Michael L. Paup, Glenn L. Archer, Jr., Gary R. Allen, Kristina E. Harrigan, Tax Div., Appellate Section, Dept. of Justice, Washington, D.C., for respondent-appellee.

Appeal from the Tax Court of the United States.

Before WISDOM,* RONEY and HATCHETT, Circuit Judges.

WISDOM, Circuit Judge:

This case presents the question: are expenditures made in the investigation of the financial condition of a corporation, in preparation for a proposed acquisition of its stock, deductible as ordinary and necessary business expenses under section 162 of the Internal Revenue Code[1] or expenditures that must be capitalized under section 263? Predictably, the taxpayer contends that the expenditures are currently deductible; the Commissioner insists on capitalization. We agree, for the most part, with the Commissioner.

I.

The taxpayer, Ellis Banking Corporation, is a bank holding company doing business in Florida. During 1974, the tax year at issue, Florida law did not permit branch banking, so, to expand into new geographic markets, Ellis had no choice but to acquire the stock of other banks or to organize new banks.

On August 21, 1973, Ellis executed an agreement with Parkway National Bank of Tallahassee and certain Parkway shareholders to acquire all the stock of Parkway in exchange for Ellis

*Honorable John Minor Wisdom, U.S. Circuit Judge for the Fifth Circuit, sitting by designation.

1/ All statutory references are to the Internal Revenue Code of 1954, as amended and in effect in 1974.

stock. The agreement was subject to a number of conditions, including the following:

(1) the Federal Reserve Board would approve the acquisition,

(2) the Securities and Exchange Commission would register the Ellis stock to be exchanged,

(3) for accounting purposes, Ellis would be able to treat the acquisition as a "pooling of interests", and

(4) Parkway's financial condition would not be materially different from that set forth in financial statements supplied to Ellis.

Upon execution of the agreement, but not before, Ellis was entitled to inspect Parkway's books and records to evaluate Parkway's financial condition, to obtain the information necessary for the various applications to governmental agencies, and to verify that the exchange ratio specified in the agreement was an accurate reflection of the relative values of the Ellis and Parkway stocks. The stock exchange was finally consummated on July 12, 1975, after a downward adjustment of the exchange ratio to reflect the results of Ellis's examination of Parkway's records. Ellis capitalized the purchase price of the stock.[2]

In 1974, in connection with the examination of Parkway's books, Ellis made the following expenditures:

Office supplies	$41.86
Filing fees	100.00
Travel expenses	3,041.58
Accounting expenses	5,894.00
Total	$9,077.44

The accounting expenses included two separate amounts charged by Peat, Marwick, Mitchell & Co., Ellis's independent certified public accountant. First, Ellis paid $3,400 to Peat Marwick in connection with the registration of the Ellis stock with

2/ That "price", of course, was paid in Ellis stock rather than in money, and any reference to "price" in this opinion refers to the stock exchanged.

the SEC. The registration required Ellis to submit certain data that Peat Marwick had previously certified, but, before Peat Marwick would consent to the use of its name in connection with the certification, it determined whether any material change had occurred. Second, Ellis paid $2,494 to Peat Marwick. In a letter to Ellis, Peat Marwick explained that part of the accountants' time was spent observing Ellis's auditors, in anticipation of including Parkway in Ellis's consolidated statements and of certifying those statements. Also, Peat Marwick explained that much of the time was devoted to researching whether treatment as a "pooling of interests" was available.

Ellis deducted the $9,077.44 as an ordinary and necessary business expense under section 162. The Commissioner disallowed the deduction, and the Tax Court upheld his determination. *Ellis Banking Corporation v. Commissioner*, 1981, 41 T.C.M. 1107. The taxpayer appeals.

II.

[1] To be deductible under section 162,[3] an expenditure must meet five conditions, set out in *Commissioner v. Lincoln Savings and Loan Association*, 1971, 403 U.S. 345, 91 S.Ct. 1893, 29 L.Ed.2d 519. First, it must be paid or incurred during the taxable year. Second, it must be made to carry on a trade or

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3/ The relevant part of section 162 reads:

(a) In general. — There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including —

(1) a reasonable allowance for salaries or other compensation for personal services actually rendered;

(2) traveling expenses . . .;

(3) rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business . . .

business. Third, it must be an expense. Fourth, it must be a necessary expense. Finally, it must be an ordinary expense.[4]

The expenditures at issue here unquestionably meet most of the requirements. Ellis made the payments during the taxable year for which it claims the deductions and in the course of its business of promoting banks. Also, the payments undoubtedly met the minimal standard embodied in the requirement that the expense be "necessary", for that term is construed to mean nothing more than "appropriate and helpful". *Commissioner v. Tellier*, 1966, 383 U.S. 687, 689, 86 S.Ct. 1118, 1119, 16 L.Ed.2d 185, 187-88. The sole issue, then, is whether the expenditures were current, ordinary expenses or capital expenditures.

[2, 3] While current expenses are deductible under section 162, section 263 denies a deduction for any amounts paid out for

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4/ Although the Supreme Court set out five separate requirements, the third requirement is subsumed in the fifth. The word "ordinary" in the statute distinguishes deductible expenses from expenditures that must be capitalized and, if deductible at all, amortized over the life of the resulting asset. *See, e.g., Comm'r v. Tellier*, 1966, 383 U.S. 687, 688-90, 86 S.Ct. 1118, 16 L.Ed.2d 185, 187-88. The term "expense" as a term of art in accounting refers only to items that meet the requirement of ordinariness. The Court implicitly recognized that the fifth requirement includes the third when it phrased the question in *Lincoln Savings and Loan* as whether the payment was an expense and an ordinary one. 403 U.S. at 354, 91 S.Ct. at 1899, 29 L.Ed.2d 527. For an exhaustive discussion of the meaning of "expense" and "capital expenditure", *see NCNB Corp. v. United States*, 4 Cir. 1981, 684 F.2d 285 (en banc).

assets with lives in excess of one year. § 263(a).[5] The requirement that costs be capitalized extends beyond the price payable to the seller to include any costs incurred by the buyer in connection with the purchase, such as appraisals of the property or the costs of meeting any conditions of the sale. *See e.g., Woodward v. Commissioner*, 1970, 397 U.S. 572, 90 S.Ct. 1302, 25 L.Ed.2d 577; *United States v. Hilton Hotels Corp.*, 1970, 397 U.S. 580, 90 S.Ct. 1307, 25 L.Ed.2d 585. Further, the Code provides that the requirement of capitalization takes precedence over the allowance of deductions. §§ 161, 261; *see generally Commissioner v. Idaho Power Co.*, 1974, 418 U.S. 1, 94 S.Ct. 2757, 41 L.Ed.2d 535. Thus an expenditure that would ordinarily be a deductible expense must nonetheless be capitalized if it is incurred in connection with the acquisition of a capital asset.[6] The function of these rules is to achieve an accurate measure of net income for the year by matching outlays with the revenues attributable to them and recognizing both during the same taxable year. When an outlay is connected to the acquisition of an aset with an extended life, it would understate current net income to deduct the outlay immediately. To the purchaser, such

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5/ The relevant part of section 263 reads:

(a) General rule. — No deduction shall be allowed for —

(1) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate. This paragraph shall not apply to —

(A) expenditures for the development of mines or deposits deductible under section 616,

(B) research and experimental expenditures deductible under section 174,

(C) soil and water conservation expenditures deductible under section 175,

(D) expenditures by farmers for fertilizer, etc., deductible under section 180,

(E) expenditures by farmers for clearing land deductible under section 182, or

(F) expenditures for removal of architectural and transportation barriers to the handicapped and elderly which the taxpayer elects to deduct under section 190.

(2) Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made.

The courts have uniformly interpreted this provision as denying a deduction for the cost of any long-lived asset; its list is not exhaustive. *See, e.g., Comm'r v. Lincoln Sav. and Loan Ass'n*, 1971, 403 U.S. 345, 358, 91 S.Ct. 1893, 1901, 29 L.Ed.2d 519, 529.

6/ We do not use the term "capital asset" in the restricted sense of section 1221. Instead, we use the term in the accounting sense, to refer to any asset with a useful life extending beyond one year.

outlays are part of the cost of acquisition of the asset, and the asset will contribute to revenues over an extended period. Consequently, the outlays are properly matched with revenues that are recognized later and, to obtain an accurate measure of net income, the taxpayer should deduct the outlays over the period when the revenues are produced.

[4] These principles, we conclude, require capitalization of most of the expenditures in this case.[7] Ellis expected to realize

7/ We do not mean to overstate the simplicity of these rules. In the case before us, they are of relatively easy application. The proper line between deduction and capitalization, however, becomes much more difficult to draw when the long-lived benefit achieved as the result of an expenditure is not a tangible asset or a readily identifiable intangible asset. *See Iowa-Des Moines Nat'l Bank v. Comm'r*, 1977, 68 T.C. 872, *aff'd*, 8 Cir. 1979, 592 F.2d 433. That problem has received a great deal of judicial attention, with results that are not entirely consistent. *See, e.g., Comm'r v. Lincoln Sav. and Loan Ass'n.*, 1971, 403 U.S. 345, 91 S.Ct. 1893, 29 L.Ed.2d 519; *Welch v. Helvering*, 1933, 290 U.S. 111, 54 S.Ct. 8, 78 L.Ed.2d 212; *NCNB Corp. v. United States*, 4 Cir. 1981, 651 F.2d 942, *vacated pending rehearing en banc* (No. 78-1771); *First Nat'l Bank v. United States*, 4 Cir. 1977, 558 F.2d 721 (per curiam); *Briarcliff Candy Corp. v. Comm'r*, 2 Cir. 1973, 475 F.2d 775; *United States v. Akin*, 10 Cir. 1957, 248 F.2d 742, *cert. denied*, 1958, 355 U.S. 956, 78 S.Ct. 542, 2 L.Ed.2d 532; *Southland Royalty Co. v. United States*, Ct.Cl. 1978, 582 F.2d 604, *cert. denied*, 1979, 441 U.S. 905, 99 S.Ct. 1991, 60 L.Ed.2d 373. This case, fortunately, does not present such intractable problems, for the taxpayer unquestionably made the expenditures in an attempt to acquire an identifiable asset — the stock of Parkway — to which the costs should be attributed.

One of these difficult cases deserves closer attention. *NCNB Corp. v. United States*, 4 Cir. 1981, 651 F.2d 942, *vacated pending rehearing en banc* (No. 78-1771), involved a taxpayer bank that expanded into new markets by branching. A divided panel of the Fourth Circuit required the taxpayer to capitalize the costs of preparing studies of the banking markets in various cities. This case is a stronger case for requiring capitalization, for two reasons. First, some of the studies in *NCNB* were not studies primarily of a single branch location but of an entire market. They were therefore more closely related to general management planning than was the investigation here. Other studies at issue in *NCNB*, though, were studies of a specific location, indistinguishable from studies of a specific potential subsidiary. Second, the taxpayer here acquired what is unquestionably an asset — the stock of Parkway — while the taxpayer in *NCNB* acquired only whatever long-term utility the studies had, far less clearly an identifiable asset. If the view of the panel in *NCNB* does not prevail on rehearing, this latter distinction may present an anomaly: a bank that expands into new markets by branching can deduct investigation costs while a bank that expands into new markets by acquiring the stock of other banks must capitalize those investigation costs. But we think that the anomaly militates in favor of recognizing that investigation by a branching bank of specific potential branch locations creates an asset, the cost of which should be capitalized, rather than adopting the fiction that the investigation of a potential subsidiary by a bank holding company is not connected to the acquisition of shares of stock that are undeniably an asset with an extended useful life.

benefits over the course of its ownership of the Parkway stock, and the investigation expenditures, which were directly related to an examination of this specific property, were part of the cost to Ellis of owning the stock. Those expenditures should be deducted only when the related benefits are realized. *See, e.g., Union Mutual Life Insurance Co. v. United States*, 1 Cir. 1978, 570 F.2d 382, *cert. denied*, 439 U.S. 821, 99 S.Ct. 87, 58 L.Ed.2d 113;[8] *Cagle v. Commissioner*, 5 Cir. 1976, 539 F.2d 409; *Beneficial Industrial Loan Corp. v. Handy*, D. Del. 1936, 16 F.Supp. 110, *aff'd*, 3 Cir. 1937, 92 F.2d 74 (per curiam); Rev. Rul. 77-254, 1977-2 Cum. Bull. 63; Rev. Rul. 74-104, 1974-1 Cum. Bull. 70; Rev. Rul. 71-191, 1971-1 Cum. Bull. 77, *clarified*, Rev. Rul. 79-346, 1979-2 Cum. Bull. 84.[9]

One of the major functions of the examination of Parkway's books was to determine the appropriateness of the exchange ratio, or the acquisition price. In *Woodward* and *Hilton*, the Supreme Court held that the taxpayers had to capitalize the costs of appraisal proceedings as part of the cost of the stock ac-

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8/ The taxpayer in *Union Mutual* was a life insurance company, subject to the provisions of subchapter L, §§ 801-820. The question was whether a deduction was allowable under section 804(c)(1). The difference is insignificant, though, for the court required that the taxpayer qualify under section 162 in order to take a deduction under section 804(c)(1). 570 F.2d at 390.

Ellis attempts to distinguish *Union Mutual* because the expenditures there were made in the course of investigating real estate investments, and the taxpayer, according to Ellis, was a life insurance company and therefore not in the business of investing in real estate. Ellis misreads *Union Mutual*. Although the taxpayer's primary business was life insurance, it regularly invested substantial sums in real estate, and the court referred to its "real estate business". *Id.* at 389.

9/ Ellis takes issue with this application of the general principles stated earlier, arguing that *York v. Commissioner*, 4 Cir. 1958, 261 F.2d 421, permits deduction of the costs of investigating an investment if the taxpayer is in the business of making such investments, even if the investigation is connected with the acquisition of a capital asset. In *York*, the taxpayer was in the business of developing commercial and residential real estate. He commissioned a study of the industrial potential of a tract of land and sought to deduct the cost. The Fourth Circuit, reversing the Tax Court, allowed the deduction, after concluding that development of industrial real estate is the same business as development of commercial and residential real estate. It never considered the possibility that the expenditure might be capital in nature, focusing solely on the requirement of section 162 that the taxpayer be in the trade or business. We will not follow an implicit holding on a question never considered by the court, for the great weight of authority, which we have cited in text, and our examination of the relationship of sections 162 and 263 establish that the cost of investigating an investment is part of the cost of the investment, even if the taxpayer is not entering a new business.

quired, saying, "When property is acquired by purchase, nothing is more clearly part of the process of acquisition than the establishment of a purchase price." *Woodward*, 397 U.S. at 579, 90 S.Ct. at 1307, 25 L.Ed.2d at 583; *see Hilton*, 397 U.S. at 584, 90 S.Ct. at 1309, 25 L.Ed.2d at 588. And in *Beneficial Industrial Loan Corp. v. Handy*, D. Del. 1936, 16 F.Supp. 110, *aff'd*, 3 Cir. 1937, 92 F.2d 74 (per curiam), the court held that it was "too clear for argument" that the costs of obtaining an accountants' evaluation of a target corporation were not deductible. 16 F.Supp. at 112. Those expenditures should therefore be capitalized.

Ellis relies on two main arguments in favor of deductibility. First, it makes a general argument about all the costs — that the expenditures were not made in connection with the *acquisition* but in connection with the *decision* to acquire the stock and with the evaluation of the Tallahassee market. Next, Ellis falls back on a specific argument about the accounting fees — that the accounting firm was performing its general duty of supervising Ellis's auditors to provide Ellis with financial information and to prepare Ellis's income tax returns.[10] We think that neither argu-

10/ Ellis also devotes a portion of its brief to arguing that it is in the business of promoting banks, so that the expenditures made in that business are deductible. It is not enough to establish that expenditures are incurred in carrying on a trade or business to qualify for a deduction under section 162 — *all* of the requirements set out above must be fulfilled. Indeed, if being in the business sufficed, Ellis would be able to deduct the purchase price of the Parkway stock.

It is for this reason that much of the authority relied upon by the taxpayer is inapposite. For instance, Ellis relies heavily on *Price v. Comm'r*, 1971, 30 T.C.M. 1405-3. The taxpayer in that case was an individual employed by a corporation. He expended sums in conducting activities preliminary to organizing a bank, expecting to receive an ownership interest in the bank. The project was abandoned, and the taxpayer attempted to deduct his expenditures. The Tax Court denied a section 162 deduction, stating that the taxpayer was not in the trade or business of promoting banks. Ellis insists that this case stands for the proposition that a taxpayer who is in the business of promoting banks may deduct initial investigatory expenditures under section 162. Of course the case does not establish such a role — a holding that the taxpayer has failed to meet one of five conjunctive requirements does not in any way suggest that he has met the others. Indeed, in *Price*, the Tax Court went on to hold that a deduction for an ordinary and necessary expense for the production of income under section 212 was inappropriate, for, "until the charter was granted, there would be no production of income. Until that time, the expenses were merely capital expenditures." *Id.* at 1410. The court then permitted the deduction of a loss under section 165(c)(2), stating, "Since the expenses could have been capitalized if the project had been successful, we see no reason not to allow the deduction of these expenditures as a loss when the project is abandoned." *Id.* Obviously, the court viewed a deduction for a current expense under section 162 as improper, even if the taxpayer had been in the trade or business of promoting banks.

ment supports the entire deduction, but the second argument compels us to remand to the Tax Court for a determination of the appropriateness of a partial deduction.

In connection with its first argument, Ellis notes that it was not committed to purchase the Parkway stock at the time it made the expenditures because the contract was subject to several conditions. In fact, the examination of Parkway's books revealed changes in its financial condition that would have excused Ellis's performance, and Ellis would not have completed the transaction without a downward adjustment of the exchange ratio. Furthermore, Ellis contends, the examination of Parkway's books provided general information about Parkway[11] that aided in management decision-making.

[5] We agree with Ellis that the expenditures were made in the investigation of Parkway and without a firm commitment to buy. Nevertheless, they are not deductible. As we have discussed, the expenses of investigating a capital investment are properly allocable to that investment and must therefore be capitalized. That the decision to make the investment is not final at the time of the expenditure does not change the character of the investment; when a taxpayer abandons a project or fails to make an attempted investment, the preliminary expenditures that have been capitalized are then deductible as a loss under section 165. *See, e.g., Radio Station WBIR, Inc. v. Commissioner*, 1959, 31 T.C. 803, 814, 815-16; *Champlain Coach Lines v. Commissioner*, 2 Cir. 1943, 138 F.2d 904; Rev. Rul. 77-254, 1977-2 Cum. Bull. 63; Rev. Rul. 74-104, 1974-1 Cum. Bull. 70; Rev. Rul. 71-191, 1971-1 Cum. Bull. 77, *clarified*, Rev. Rul. 79-346, 1979-2 Cum. Bull. 84. As the First Circuit stated, ". . . expenditures made with the *contemplation* that they will result in the creation of a capital asset cannot be deducted as ordinary and necessary

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11/ Ellis also contends that the examination of Parkway's books provided general information about the Tallahassee market. The Tax Court made no such finding, viewing the examination as connected with the Parkway acquisition. That view of the facts is not clearly erroneous. Even if the examination had produced information about the Tallahassee market that, as Ellis contends, would continue to be useful in its business of holding banks, that future benefit of the study might require capitalization and amortization over the period during which the study was expected to have utility. *See NCNB Corp. v. United States*, 4 Cir. 1981, 651 F.2d 942, *vacated pending rehearing en banc* (No. 78-1771).

business expenses even though that expectation is subsequently frustrated or defeated." *Union Mutual*, 570 F.2d at 392 (emphasis in original). Nor can the expenditures be deducted because the expectations might have been, but were not, frustrated.

[6] Next, Ellis contends that the charges of Peat Marwick were attributable to its performance of its general duties. The $3,400 payment to Peat Marwick covered the re-examination of material to be certified in the registration filed with the SEC. Ellis contends that this service provided it with valuable financial information about itself and that it should therefore be deductible just as expenses incurred for general financial accounting for management are. It relies on *Southern Engineering and Metal Products Corp. v. Commissioner*, 1950, 9 T.C.M. 93. In that case, a corporation undertook an appraisal of its equipment to establish an inventory. When one of the two shareholders later bought out the other, the survey was used to value the shares. The Tax Court held that this incidental use of the survey in a capital transaction did not preclude an otherwise allowable deduction. Here, the accounting work was done to comply with a condition of the purchase agreement — registration of the Ellis stock with the SEC, and it was only incidental that Ellis gained any information about itself. When an expenditure is primarily in connection with the acquisition of a capital asset, and there is only an incidental and attenuated benefit that might otherwise lead to a deductible expense, *Southern Engineering* does not require us to permit a deduction.

The other component of the payment to Peat Marwick, $2,494, arose, according to Ellis, in connection with Peat Marwick's auditing duties. Although Peat Marwick explained that much of that amount was attributable to time spent researching whether treatment as a "pooling of interests" was available for accounting purposes — research necessary to determine whether a condition of the acquisition agreement was met — it also stated that part of the time was attributable to the observation of Ellis's auditors in connection with Peat Marwick's general auditing duties. The portion attributable to research is directly connected with the acquisition of Parkway and must be capitalized, but deduction of general auditing expense would be appropriate. The Tax Court declined to express any opinion on

the question whether part of the $2,494 payment was actually properly attributable to general auditing, holding that, even if a portion was attributable to auditing, the taxpayer had offered no basis for allocation of the payment between expense and capital expenditure. The taxpayer ordinarily has the burden of proof in a challenge of the Commissioner's determination, *see* Tax Ct. R. 142(a); *Hartman v. Commissioner*, 1975, 65 T.C. 542. The Tax Court concluded therefore that Ellis's failure to establish the proper allocation precluded any deduction. We agree, of course, that the taxpayer generally has the burden of proof. But, under the "*Cohan* rule", if it is clear that the taxpayer is entitled to *some* deduction, but he cannot establish the full amount claimed, it is improper to deny the deduction in its entirety. Instead, the court should estimate to the best of its ability, retaining always the power to "bear[ ] heavily . . . upon the taxpayer whose inexactitude is of his own making". *Cohan v. Commissioner*, 2 Cir. 1930, 39 F.2d 540, 544 (L. Hand, J.).[12] *See generally* 4A J. Mertens, Law of Federal Income Taxation § 25.04 (Doheny rev. ed. 1979). It is therefore necessary to determine whether Ellis has established that part of the expenditure is attributable to Peat Marwick's general auditing duties. If it has, the Tax Court should estimate the amount allocable to general auditing and permit a deduction in that amount. If it has not, of course, Ellis must capitalize the entire amount as part of the cost of the Parkway stock, for the *Cohan* rule will apply only if Ellis can show its entitlement to *some* deduction. *See Bay Sound Transportation Co. v. United States*, 5 Cir. 1969, 410 F.2d 505, 511, *cert. denied*, 396 U.S. 928, 90 S.Ct. 263, 24 L.Ed.2d 226.

12/ The rule as announced in *Cohan* applied to travel and entertainment expenses. In that area, Congress has overruled the result in section 274(d), which imposes a heavy burden of substantiation on a taxpayer claiming deductions under section 162 for travel and entertainment expenses. But the *Cohan* principle was applied more generally and apparently survives where not legislatively overruled. *See, e.g., Cummings v. Comm'r*, 5 Cir. 1969, 410 F.2d 675, 679; *Green v. Comm'r*, 1980, 74 T.C. 1229, 1237; *see generally* 4A J. Mertens, Law of Federal Income Taxation § 25.04 (Doheny rev. ed. 1979). As Mertens explains,

> . . . [A] taxpayer would [otherwise] in every case be denied a deduction for otherwise allowable expenses where there was a failure of strict proof on his part. Thus, even . . . . . .

III.

With the possible exception of part of the $2,494 payment to Peat Marwick, the expenditures that Ellis seeks to deduct are properly attributable to the acquisition of the Parkway stock. They are therefore capital in nature and not deductible under section 162. The case is AFFIRMED IN PART AND REMANDED IN PART.

[CCH Dec. 37,759(M)] Ellis Banking Corporation v. Commissioner.

Docket No. 13848-78. T. C. Memo. 1981-123. Filed March 17, 1981. [Appealable, barring stipulation to the contrary, to CA-5.—CCH.]

[Code Secs. 162 and 263]

[Capital expenditures: Deductibility: Business expense distinguished: Stock acquisition: Costs incurred: Ordinary and necessary business expenses.] ***Held,*** **certain accounting and other expenses incurred by petitioner, a bank holding corporation, were incurred in connection with the acquisition of the stock of another bank, a capital asset, and must be capitalized and are not deductible as ordinary and necessary business expenses.**

Michel G. Emmanuel and Nathaniel L. Doliner, P.O. Box 3239, Tampa, Fla., for the petitioner. Victor Becker, for the respondent.

Memorandum Findings of Fact and Opinion

DRENNEN, Judge: In the statutory notice of deficiency respondent determined a deficiency of $24,171 in petitioner Ellis Banking Corporation's income tax for 1974.

Due to concessions by both parties,[1] the sole issue for deci-

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1/ In the statutory notice of deficiency, respondent also made an adjustment to petitioner Ellis Banking Corporation's charitable contribution deduction. This adjustment was an automatic result of respondent's other adjustments and of the application of the limitation imposed on charitable contribution deduction. This adjustment was an automatic result of respondent's other adjustments and of the application of the limitation imposed on charitable contribution deductions by sec. 170(b)(2). I. R. C. 1954. The deduction ultimately allowable can be mathematically determined based on the parties concessions as to some issues and the court's resolution of the issue pending.

Petitioner Ellis Banking Corporation in its petition prays that the Court award it reasonable attorney's fees and expenses pursuant to Pub. L. 94-559, 90 Stat. 2641, Oct. 19, 1976, amending 42 U. S. C. sec. 1988. This Court is without jurisdiction to award to petitioner attorney's fees and expenses connected with this litigation, *Key Buick Co. v. Commissioner* [Dec. 34,407], 68 T. C. 178 (1977), affd [80-1 USTC ¶ 9306] 613 F. 2d 1306 (5th Cir. 1980).

sion is whether certain expenditures incurred by petitioner Ellis Banking Corporation were ordinary and necessary business expenses properly deductible under section 162, I. R. C. 1954,[2] or whether they were costs incurred in connection with the acquisition of a capital asset and thus required to be capitalized under section 263.

Findings of Fact

Some of the facts were stipulated and they are so found. The stipulations of fact, together with the exhibits attached, are incorporated herein by this reference.

Petitioner Ellis Bank Corp. (hereinafter petitioner) is a Florida corporation which had its principal place of business in West Bradenton, Fla., when its petition was filed in this case. Petitioner, an accrual-method taxpayer, filed a consolidated Federal income tax return, form 1120, for the calendar year 1974 with the Internal Revenue Service Center, Chamblee, Ga. Petitioner has filed consolidated income tax returns since 1972.

I. Background Information

Petitioner is a registered bank holding company established under the Bank Holding Company Act of 1956, ch. 240, 70 Stat. 133, 12 U. S. C. sec. 1841 *et seq.*, as amended. It was organized as a bank holding company in March 1972 with 15 banks as subsidiary corporations. Originally, a controlling stock interest in these 15 banks had been acquired individually, beginning in 1946, by A. L. Ellis, petitioner's chairman of the board, and/or his wife. The stock of these banks was exchanged for stock in petitioner. Between March 1972 and December 1974 petitioner organized or acquired six additional subsidiary banks.

The bank-holding-company concept was popular in Florida during the time petitioner was organized because it provided a vehicle by which a bank could expand its business into new market areas. At that time Florida State law did not permit a

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2/ All section references are to the Internal Revenue Code of 1954, as amended and in effect for the taxable year in issue, unless otherwise indicated.

bank to establish branches, thereby limiting a bank's growth potential. By organizing a bank holding company which could own the stock of various individual banks, the business of a single "bank" organization could be expanded either by acquiring the stock of existing banks or by organizing new bank corporations. Subsequent to the years here involved, Florida law was changed to permit a bank to establish a branch in the particular county in which the bank was located. This change reduced the utility of the bank-holding-company concept as a vehicle to expand a bank's business.

Petitioner acquired the stock of various banks, both for cash and by way of exchanges of stock, as a means of expanding its business. It has never sold a bank and it does not organize and acquire banks with the intention of selling them. Since county-wide branch banking has been permitted, petitioner has acquired the stock of only four banks while establishing fourteen branches of existing subsidiary banks.

Although petitioner supervises its subsidiary banks, it does not manage their day-to-day operations. Those duties are performed by the management employees of the individual banks. However, certain large loans to be made by a subsidiary must be approved by petitioner. In addition, petitioner does perform services for the subsidiary banks through its following divisions:

(a) Accrual — Performs the income and expense auditing for petitioner and its subsidiary banks;

(b) Accounting — Performs petitioner's accounting and assists its subsidiary banks in accounting matters, and prepares tax returns and consolidated statements;

(c) Credit — Obtains large national lines of credit for its subsidiary banks, assists them in analyzing credit, audits large loans, and assists its subsidiary banks in managing large loans.

(d) Executive — Establishes management policy for petitioner and its subsidiaries; and

(e) Audit — Performs statutorily required auditing and audits its subsidiary banks for management purposes.

The sources of petitioner's income are dividends from subsidiary banks and management fees paid by its subsidiary banks for services. Petitioner uses its income to operate, pay dividends, and organize and manage banks.

II. Bank Acquisition in Issue

By letter dated June 11, 1973, petitioner offered, subject to certain terms and conditions, to exchange shares of its $1-par-value common stock for all the 35,000 issued and outstanding shares of $10-par-value common stock of Parkway National Bank of Tallahassee (hereinafter Parkway). The offer contained in the letter was the result of prior discussions between petitioner and Parkway and it reflected a preliminary agreement between them as to the purchase offer and the principal conditions thereof. Included among the conditions of the purchase offer was the following:

> For the purpose of preparing the application for approval by the Board of Governors of the Federal Reserve System of the proposed acquisition, authorized representatives of Ellis, including its audit staff, and members of the firm of Peat, Marwick, Mitchell & Company, Certified Public Accountants, shall have the right to examine the books and records of the Bank [Parkway] as they may deem necessary. Such examination shall be completed within sixty (60) days from the date of the acceptance of this offer by the Board of Directors of the Bank (unless the completion date is extended by mutual agreement), and you will then be notified whether Ellis will proceed with the Plan of Acquisition. If the examination discloses any fact or condition not previously disclosed to Ellis which, in Ellis's opinion, may be detrimental to the financial condition of the Bank of [*sic*] Ellis, or which may cast doubt on the accuracy and fairness of the exchange ratio provided herein, this Letter Agreement and the related Plan of Acquisition may be terminated and withdrawn. This proposal shall be conditioned upon there being no substantial adverse change in the financial condition of the Bank, or its results of

operation from that shown on its most recent Statement of Condition and the Income Statement, for the period ending on the same date as the Bank's most recent Statement of Condition.

Parkway's board of directors approved petitioner's offer on June 14, 1973.

On August 21, 1973, petitioner, Parkway and certain of Parkway's shareholders executed an agreement for the acquisition of Parkway common stock. This agreement superseded the offer contained in petitioner's letter of June 11, 1973. The introductory paragraphs of this agreement provided that it was the intent of the parties thereto that petitioner acquire all (but not less than 90 percent) of the Parkway shares outstanding and that the exchange of stock in petitioner for stock in Parkway qualify as a reorganization under section 368(a)(1)(B). The agreement also contained certain terms and conditions which qualified petitioner's offer to acquire Parkway stock. Among the terms and conditions contained in the agreement were:

(A) The holders of at least 90 percent of the outstanding shares of Parkway stock tender their shares to petitioner under the terms of the exchange offer. If less than 90 percent of the stock was tendered, petitioner had the option of accepting the stock tendered or withdrawing its offer.

(B) A ruling be obtained from the Internal Revenue Service that petitioner's acquisition of Parkway stock qualified as a tax-free reorganization under section 368(a)(1)(B). If a ruling was not obtained, either petitioner or Parkway had the option of terminating the exchange.

(C) The Board of Governors of the Federal Reserve System shall have approved petitioner's application to acquire the Parkway stock, and all other required governmental approvals shall have been obtained and not withdrawn.

(D) A registration statement shall have been declared effective by the Securities and Exchange Commission registering the stock of petitioner to be exchanged for that of Parkway.

(E) For accounting purposes petitioner be able to treat the acquisition of the Parkway stock as a "pooling of interest." If it was determined that the acquisition could not be so treated, petitioner had the option of withdrawing its offer.

(F) There shall have been no material adverse change in Parkway's financial condition from that set forth in the financial statements which Parkway supplied to petitioner.

The agreement also authorized petitioner to examine Parkway's books and records in order to determine whether the conditions above set forth in paragraphs (E) and (F) were satisfied and for purposes of (1) compiling the information needed for preparing the necessary documents required to be submitted to various Government agencies; (2) ensuring that the financial information presented by Parkway was accurate and that there was no undisclosed fact or condition which would adversely affect the financial condition of either petitioner or Parkway, or which would affect the exchange ratio of stock in petitioner for stock in Parkway; and (3) reviewing records required for petitioner's consolidated statements.

Subsequent to the agreement of August 21, 1973, petitioner's employees and its independent certified public accountant conducted an examination of Parkway's books and records. In connection therewith, during 1974 petitioner incurred the following expenses:

Description	Amount
Office supplies	$ 41.86
Filing fees	100.00
Travel expenses	3,041.58
Accounting expenses	5,894.00
	$ 9,077.44

Petitioner deducted these amounts as ordinary and necessary business expenses on its 1974 consolidated income tax return.

Other than including them in the list of expenditures, no further evidence was provided concerning the expenditures for

office supplies and filing fees. The $3,041.58 amount for travel expenses was for the travel of petitioner's employees to Tallahassee, Fla., to examine the books and records of Parkway. Included in this amount were lodging and meal expenses.

The $5,894 amount for accounting expenses was composed of separate amounts of $2,494 and $3,400[3] paid to Peat, Marwick, Mitchell & Co. (hereinafter Peat Marwick), petitioner's independent certified public accountant.

On April 18, 1974, Peat Marwick rendered to petitioner a bill which included a $2,494 amount for "Professional services rendered in connection with proposed acquisition of Parkway * * *, including travel and other expenses of $238." In response to an inquiry by petitioner concerning the $2,494 amount, Peat Marwick further explained the amount as follows:

Personnel	Hours
Partner	21
Manager	31
Assistant	1
	53
Fee at standard	$2,820
Realization—80%	2,256
Travel, typing, Xeroxing and telephone expenses	228
Total	$2,494 [4]

major portion of the manager time was spent in participating and observing Ellis group auditors in the conduct of an examination in July, 1973. In addition, certain procedures were performed with respect to the local CPA's work and Parkway

3/ The parties stipulated that the $3,400 amount was paid in connection with the examination of Parkway's books and records. Based on the record before us, *infra*, it appears that the amount was paid for services rendered in connection with solely reviewing petitioner's financial information. Neither party makes mention of this point, however, and we believe it inconsequential in deciding the issue presented.

4/ The correct total for the figures is $2,484. The error in no way affects the outcome of the case.

The major portion of the manager time was spent in participating and observing Ellis group auditors in the conduct of an examination in July, 1973. In addition, certain procedures were performed with respect to the local CPA's work and Parkway records to enable us to rely on the opinion of the other auditors in the event we deemed it necessary. Certainly in the conduct of any future audit of this bank by us, such time will be of benefit.

A portion of the manager time and most of the partner time resulted from research regarding the appropriateness of the use of the pooling of interest method of accounting, review of the Acquisition Agreement in relation thereto and various letters dated November 7, 1973, November 16, 1973, December 5, 1973, January 24, 1974 and February 15, 1974, all in response to your letter of August 29, 1973.

Petitioner paid the $2,494 amount by check dated August 16, 1974.

Although Peat Marwick was requested to do whatever was necessary for petitioner's consolidated statements, it was not specifically asked to observe the audit of Parkway by petitioner's employees. Peat Marwick did so, however, as part of making whatever spot checks and verifications it deemed appropriate in fulfulling its general responsibilities in certifying petitioner's consolidated statements. This action by Peat Marwick was in anticipation of including Parkway in, and of certifying, petitioner's consolidated statements for 1974.

As part of the S-1 registration filed with the Securities and Exchange Commission to register the stock petitioner would exchange for the Parkway stock, petitioner was required to submit certain data for 1973 which Peat Marwick had previously certified. Before Peat Marwick consented to the use of its name in connection with the certification of this data, Peat Marwick determined if there had been any material change in the data since the previous certification had been made. On July 31, 1974, Peat Marwick rendered to petitioner a bill in the amount of $3,400 for the services rendered in making this determination and in signing the consent on the S-1 registration. Petitioner paid the $3,400 amount by check dated August 12, 1974.

Ultimately, on July 12, 1975, petitioner acquired all of the stock of Parkway in a nontaxable stock exchange. As a result of the investigation of Parkway's books and records, a downward adjustment was made to the originally agreed upon exchange ratio of petitioner and Parkway stock. Had Parkway not agreed to this downward adjustment, petitioner would have abandoned its plan to acquire the Parkway stock.

In the statutory notice of deficiency, respondent determined that no portion of the $9,077.44 amount deducted by petitioner was deductible. Such expenses were determined to be part of the costs of acquiring the Parkway stock.

Opinion

The issue for decision is whether petitioner properly deducted, as ordinary and necessary business expenses under section 162, certain expenditures incurred in connection with the examination of the books and records of the Parkway National Bank of Tallahassee, prior to but incident to the acquisition of Parkway's stock by petitioner in 1975, and in connection with the preparation of necessary documents conc ning the acquisition of the Parkway stock required to be submitted to appropriate governmental agencies.

The details of these expenditures and the purposes for which they were made are outlined in the Findings of Fact. There is no question that the amounts deducted were in fact expended.

In the absence of evidence to the contrary, we must assume that the expenditures for office supplies pertained to supplies used both in examining Parkway's books and records and in preparing the necessary submissions. Similarly, we must assume that the filing fee expenditure was for fees paid when submitting required documents to governmental agencies. The expenditure for travel expenses was for costs incurred by petitioner's employees for transportation, lodging, and meal expenses incurred in examining the books and records of Parkway.

The expenditure for accounting services represented two separate amounts, $2,494 and $3,400, paid to Peat Marwick,

petitioner's independent certified public accountant. The principal evidence as to the services provided in return for the $2,494 payment was the explanation provided by Peat Marwick in a letter to petitioner. No employee of Peat Marwick testified. Similarly, the principal evidence as to the services provided in return for the $3,400 payment was the explanation included on the bill which Peat Marwick tendered to petitioner. Both explanations are set forth in the Findings of Fact.

Petitioner's argument in support of its deduction of the expenditures in issue runs along the following lines. Petitioner contends that it is in the active trade or business of banking, that it conducts its banking business through subsidiary banks, and that an important aspect of its business (as a means of expanding its business into new markets) involves acquiring, managing, and promoting banks. Because of legal restrictions during the period involved on establishing branch banks, other banks were acquired by petitioner as a means of expanding its business into new markets. In determining which banks to acquire, it was necessary to expend funds to investigate the financial condition of potential acquisitions. Such expenditures, petitioner contends, are the type at issue herein and are ordinary and necessary expenses of its banking business. This is true, petitioner argues, notwithstanding that the purchase price of the Parkway stock must be capitalized and that the expenditures were incurred after the offer to purchase was made and the agreement for acquisition was signed. Petitioner explains that because the banking industry practice was not to allow a prospective purchaser to examine the books and records of a to-be-acquired bank in the absence of a contract to purchase, it was first necessary to enter into such a contract before a full investigation was completed and the decision to acquire was made. The prospective purchaser was protected, however, by the many conditions precedent to fulfillment of the contract to purchase. Petitioner contends that this general pattern was followed in petitioner's acquisition of the Parkway stock. Petitioner finally contends that until the many conditions precedent were satisfied or, if waivable, were waived, it reserved its decision whether to acquire the Parkway stock; that the expenditures in issue were incurred prior to the time when this decision was made and were "ordinary and necessary" in making the

decision; and that because of such facts they are ordinary and necessary business expenses and not costs incurred in connection with the acquisition of the Parkway stock.[5] In addition and alternatively, petitioner argues that the $2,494 portion of the amount paid to Peat Marwick was in connection with Peat Marwick's general responsibility to certify petitioner's financial statements and not in connection with the Parkway stock acquisition.

In response to petitioner's arguments respondent contends that the expenditures in question are not deductible under secton 162(a) for two reasons: (1) They were not incurred in petitioner's trade or business since a search for or investigation of a business in which to invest is not the "carrying on" of a trade or business within the meaning of section 162(a); and (2) they were incurred in connection with the acquisition of a capital asset, the Parkway stock, and must be capitalized pursuant to section 263 as part of the costs of that asset.

As a matter of convenience, we first address petitioner's alternative argument that the $2,494 expenditure for accounting services by Peat Marwick is somehow distinct from the other expenditures because it was for services "in connection with Peat Marwick's continuing function of preparing petitioner's financial statements." The argument for separately treating this expenditure is belied by the explanation of the amount provided by Peat Marwick. Included within the services for which the bill was rendered was time spent in researching whether the acquisition of the Parkway stock could be accounted for as a pooling of interest. Although such research may also have been valuable in terms of Peat Marwick's continuing responsibility with regard to petitioner's consolidated financial statements, it appears primarily important with regard to the acquisition of the Parkway stock since petitioner's ability to treat said acquisition under this accounting procedure was a condition percedent to petitioner's offer. Certainly, it cannot be said that the importance of the research to the stock acquisition was only incidental or that the portion of the expenditure related thereto was only

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5/ On brief, petitioner characterizes the expenditures in issue as being "relative" to the acquisition of Parkway but not in "connection" therewith. Rather, the expenditures were in "connection" with its investigation of Parkway.

incidental. Thus, even if expenditures made for services rendered in connection with any "continuing function" by Peat Marwick could be accorded a different tax treatment than the other expenditures in issue (a question on which we express no opinion), there is no basis for treating the entire $2,494 amount as being for such "continuing function" services. Nor is there any factual basis for dividing the $2,494 amount. Since petitioner has failed to establish what portion, if any, of the $2,494 amount should not be treated as for services in researching the pooling of interest question, we must accordingly proceed as if the entire amount was for such service. There being no argument that services rendered in such research were to be treated any differently than the other items in issue, we will discuss all the amounts together.

The tax treatment to be accorded the expenditures in issue involves the interaction of section 162, which allows a deduction for "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business," and section 263 which generally precludes a deduction for expenditures capital in nature. The application of section 263 takes precedence over section 162. Secs. 161, 261; *Commissioner v. Idaho Power Company* [74-2 USTC ¶ 9521], 418 U. S. 1, 17 (1974).

Respondent's first argument, which he does not press that forcefully, is that the expenditures in question were not incurred in "carrying on any trade or business" since searching for and investigating business in which to invest is not the carrying on of a trade or business. As a general rule expenditures for searching for and investigating a new business in which to invest are not allowable as deductions under section 162. *Abegg v. Commissioner* [Dec. 28,933], 50 T. C. 145, 153 (1968), affd. without discussion of this issue, [70-2 USTC ¶ 9513] 429 F. 2d 1209 (2d Cir. 1970), cert. denied 400 U. S. 1008 (1971); *Polachek v. Commissioner* [Dec. 20,453], 22 T. C. 858 (1954); *Frank v. Commissioner* [Dec. 19,702], 20 T. C. 511 (1953); *Westervelt v. Commissioner* [Dec. 15,850], 8 T. C. 1248 (1947). The rationale behind such decisions is the search and investigation is not in and of itself a trade or business and that since the expenditures are for investigating a *new* business, they are not incurred in a

trade or business which the taxpayer is *then* carrying on. We are not certain that this rationale applies to the facts of the case at bar because of the type of business engaged in by petitioner and the manner of conducting it. See *Newark Morning Ledger Co. v. United States* [75-2 USTC ¶ 9749], 416 F. Supp. 689, 693-695 (D. N. J. 1975), affd. [76-2 USTC ¶ 9523] 539 F. 2d 929 (3d Cir. 1976). However, we need not decide that argument because we conclude that respondent must prevail on his argument.

Even if these expenditures involved were incurred in carrying on petitioner's trade or business, petitioner must also show that they were "ordinary and necessary" to be deductible under section 162.

An expense may be "ordinary" in the sense of "normal, usual, or customary," *Deputy v. duPont* [40-1 USTC ¶ 9161], 308 U. S. 488, 495-496 (1940), in a taxpayer's trade or business, but still not be deductible because it was incurred in the acquisition of a capital asset. *Helvering v. Winmill* [38-2 USTC ¶ 9550], 305 U. S. 79 (1938). The principal purpose of the "ordinary" requirement "is to clarify the distinction often difficult, between those expenses that are currently deductible and those that are in the nature of capital expenditures, which, if deductible at all, must be amortized over the useful life of the asset." *Commissioner v. Tillier* [66-1 USTC ¶ 9319], 383 U. S. 687, 689-690 (1966). As said in *Commissioner v. Idaho Power Co.*, *supra* at 17:

> The clear import of sec. 161 is that **** an expenditure incurred in acquiring capital assets must be capitalized even when the expenditure otherwise might be deemed deductible under Part VI. [Which includes sec. 162.]

Thus the fact that petitioner incurs expenditures such as at issue on a recurring basis does not ensure their characterization as "ordinary" if they are incurred in the acquisition of a capital asset. *Woodward v. Commissioner* [70-1 USTC ¶ 9348], 397 U. S. 572 (1970). Nor would the fact that petitioner was engaged in the business of acquiring bank stock entitle it to deduct such expenditures if the bank stock was a capital asset and the expenditures were incurred in the acquisition thereof. *Helvering v.*

Winmill, supra. As suggested in *Woodward v. Commissioner, supra* at 577, "the simpler inquiry [is] whether the origin of the claim litigated is in the process of acquisition itself."

In *United States v. General Bancshares Corporation* [68-1 USTC ¶ 9147], 388 F. 2d 184, 187 (8th Cir. 1968), the court said:

> Whether expenses are ordinary and necessary and thus currently deductible or are capital in nature and must be added to the cost basis of the capital asset depends on the character of the transaction to which they relate. ***
>
> Generally capital expenditures occur when an improvement or betterment is made to a capital asset (sec. 263 I. R. C.) or an expense is incurred in the purchase or sale of a capital asset or the collection of capital proceeds.

There is no dispute that the Parkway stock is a capital asset and petitioner's cost of the stock given in exchange therefor must be capitalized. Nor does petitioner dispute the general proposition that costs, other than merely the purchase price, incurred in the acquisition of a capital asset must also be capitalized. As stated in *Woodward v. Commissioner, supra* at 576, "The law could hardly be otherwise, for such ancillary expenses [brokerage, accounting and similar costs] incurred in acquiring or disposing of an aset are as much part of the costs of that asset as is the price paid for it."

The narrow question presented herein is whether the expenditures in issue were incurred by petitioner in the acquisition of the Parkway stock or whether, as petitioner contends, because they were incurred as part of petitioner's decision-making process they are ordinary and necessary business expenses. The proper characterization of the expenditures in issue as either ordinary and necessary or capital in nature is a question of fact. *Commissioner v. Heiniger* [44-1 USTC ¶ 9109], 320 U. S. 467, 475 (1943).

The only reasonable conclusion which can be drawn from the facts presented is that the expenditures in issue were incurred in connection with the acquisition of a capital asset and must be

capitalized as part of the costs of acquiring the Parkway stock. Petitioner owned no interest in Parkway prior to its agreement in 1973 to acquire the Parkway stock. The expenditures in question were incurred by petitioner in fulfilling the necessary preconditions to effecting this agreement. The examination of Parkway's books and records enabled petitioner, *inter alia*, to prepare the required applications for approval by the necessary Government agencies of the stock acquisition and to determine whether petitioner could treat the acquisition for accounting purposes as a pooling of interests. Approval by the necessary government agencies of the stock acquisition was an unwaivable precondition to an actual exchange of stock. Petitioner's inability to treat the acquisition as a pooling of interests would allow petitioner to withdraw its offer. Expenditures made to satisfy these preconditions are so inexorably tied to and such an integral part of the stock acquisition that they must be considered a part of the cost thereof. Similarly, the fee paid to Peat Marwick in connection with the registration with the Securities and Exchange Commission of the stock which petitioner would exchange in the transaction is also an integral part of the stock acquisition.

In *Woodward v. Commissioner, supra,* and *United States v. Hilton Hotels Corp.* [70-1 USTC ¶ 9349], 397 U. S. 580 (1970), the Supreme Court held that litigation expenses, incurred in connection with appraisal proceedings under State law for the valuation of the minority-stockholder's stock which the majority stockholders were obligated to acquire, had their origin in the process of acquiring the stock and had to be capitalized as part of the cost of that stock. The Court considered the appraisal proceedings "no more than a substitute that state law provided for the process of negotiation as a means of fixing the price at which the stock was to be purchased," *Woodward v. Commissioner, supra* at 578, and that had the costs been incurred by the taxpayer in negotiating a purchase of the stock they would have been capital expenditures. In the instant case, one purpose of the examination of Parkway's books and records was to ensure that the financial information provided by Parkway during the preliminary negotiations was complete and accurate and, thus, that the stock-exchange ratio based on that information was accurate. As it turned out, information developed during the examination required a downward adjustment of the exchange

ratio. The expenditures in issue incurred to gauge the fairness of the stock exchange ratio are as much a part of the cost of acquiring the Parkway stock as were the expenditures in *Woodward*. See also *Beneficial Industrial Loan Corporation v. Handy* [36-2 USTC ¶ 9462], 16 F. Supp 110 (D. Del. 1936), affd. [37-2 USTC ¶ 9447] 92 F. 2d 74 (3d Cir. 1937), wherein payments for accounting services to review records of companies to be acquired in order to determine the price to be paid were held to be capital expenditures.

It is true, as petitioner points out, that until all the conditions precedent contained in the agreement were satisfied or, where applicable, waived, it had no contractual obligation to acquire the Parkway stock. The success or failure of the acquisition process, however, is not relevant in determining the character of the expenditure. *Union Mutual Life Ins. Co. v. United States* [78-1 USTC ¶ 9222], 570 F. 2d 382, 392 (1st *Cir.* 1978); *Radio Station WBIR, Inc. v. Commissioner* [Dec. 24,416], 31 T. C. 803 (1959). The link between the expenditures in issue and the stock acquisition is not negated by the absence of a contractual obligation to obtain the Parkway stock when the expenditures were incurred. The expenditures were as much a "cost" as was petitioner's cost of the stock it exchanged for the Parkway stock.

North Carolina National Bank v. United States, an unreported case (W. D. N. C. 1978, 42 AFTR 2d 78-5866, 78-2 USTC ¶ 9661), a case cited by petitioner, does not aid its argument. At issue in that case was the deductibility under section 162 of various expenditures incurred by taxpayer-bank in opening a new branch bank. The expenditures involved: (a) Application fees for governmental permission to open a new branch bank and expenses related thereto such as attorney's and consultant's fees; (b) costs for a large-scale, geographic study of possible areas in which to open a new branch bank; and (c) allocated internal taxpayer costs for salaries and expenses related to planning bank expansions and in obtaining governmental permission to open a new branch bank. The District Court found that because the offering of banking services from a new location did not reflect entry into a new trade or business, affect taxpayer's capital structure, or create a separate and distinct asset, the ex-

penditures at issue were ordinary and necessary business expenses. This case is most readily distinguishable from the one at bar by the fact that petitioner herein did acquire a separate and distinct capital asset, the Parkway stock. Although petitioner may be correct that the practical effect of the stock acquisition was the same as the opening of a new banch bank, nonetheless, a capital asset as acquired. Thus, the cited case is of no benefit to petitioner.

Similarly, *York v. Commissioner* [58-2 USTC ¶ 9952], 261 F. 2d 421 (4th Cir. 1958), revg. [Dec. 22,713] 29 T. C. 520 (1957), is of no benefit to petitioner. The issue therein was framed in terms of whether the taxpayer's expenditure for a land-development survey was an ordinary and necessary business expense of the taxpayer's business of developing and promoting real estate developments or was a nondeductible expenditure for the purpose of determining whether the taxpayer should enter a new business. Whether the expenditure related to the acquisition of a capital asset or should otherwise be capitalized was not at issue therein. While this case may provide support for petitioner's contention that investigatory expenses incurred to identify new markets in which to expand its business are ordinary and necessary business expenses, it in no way supports the argument that the expenditures in issue were not incurred in connection with the acquisition of a capital asset. *See Union Mutual Life Ins. Co. v. United States, supra* at 392.

In summary, we conclude that petitioner is not entitled to deduct the expenditures in issue under section 162. Even if it was within petitioner's trade or business to acquire the stock of Parkway such would not entitle it to the deduction sought since the expenditures in question were costs incurred in the acquisition of a capital asset and must be capitalized. *Helvering v. Winmill, supra.*

Decision will be entered under Rule 155.

CORRECTED

United States Court of Appeals

FOR THE ELEVENTH CIRCUIT

No. 81-5895

T.C. No. 13838-78

ELLIS BANKING CORPORATION,

Petitioner-Appellant,

versus

COMMISSIONER OF INTERNAL REVENUE SERVICE,

Respondent-Appellee.

Appeal from the Tax Court of the United States

Before WISDOM*, RONEY and HATCHETT, Circuit Judges.

JUDGMENT

This cause came on to be heard on the transcript of the record of the Tax court of the United States, and was argued by counsel;

ON CONSIDERATION WHEREOF, it is now here ordered and adjudged by this Court that the decision of the said Tax Court in this cause be, and the same is hereby, AFFIRMED IN PART; and that this cause be, and the same is hereby, REMANDED to the said Tax Court in accordance with the opinion of this Court;

It is further ordered that petitioner-appellant be condemned to pay three-fourths of the costs on appeal to be taxed by the Clerk of this Court; and that respondent-appellee be condemned to pay one-fourth of said costs.

October 15, 1982

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*Honorable John Minor Wisdom, U.S. Circuit Judge for the Fifth Circuit, sitting by designation.

ISSUED AS MANDATE: MAR -4 1983

IN THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

No. 81-5895

ELLIS BANKING CORPORATION,
Petitioner-Appellant,

versus

COMMISSIONER OF INTERNAL REVENUE SERVICE,
Respondent-Appellee.

Appeal from the United States Tax Court

ON PETITION FOR REHEARING AND SUGGESTION FOR REHEARING EN BANC
(Opinion October 15, 1982, 11 Cir., 198 , F.2d).
( )

Before WISDOM*, RONEY and HATCHETT, Circuit Judges.
PER CURIAM:

(XX) The Petition for Rehearing is DENIED and no member of this panel nor Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc (Rule 35, Federal Rules of Appellate Procedure; Eleventh Circuit Rule 26), the Suggestion for Rehearing En Banc is DENIED.

( ) The Petition for Rehearing is DENIED and the Court having been polled at the request of one of the members of the Court and a majority of the Circuit Judges who are in regular active service not having voted in favor of it (Rule 35, Federal Rules of Appellate Procedure; Eleventh Circuit Rule 26), the Suggestion for Rehearing En Banc is also DENIED.

( ) A member of the Court in active service having requested a poll on the reconsideration of this cause en banc, and a majority of the judges in active service not having voted in favor of it, rehearing en banc is DENIED.

ENTERED FOR THE COURT:

/s/ PAUL H. RONEY
United States Circuit Judge

*Honorable John Minor Wisdom, U.S. Circuit Judge for the Fifth Circuit, sitting by designation.